

## Message Text

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ACTION EA-14

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NSAE-00 XMB-07 OPIC-12 LAB-06 SIL-01 IGA-02 AGR-20

TAR-02 DODE-00 PA-04 USIA-15 PRS-01 DRC-01 IO-14 /206 W

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AMCONSUL HONG KONG

UNCLAS SEOUL 8543

HONG KONG FOR REG FIN ATT

E.O. 11652: N/A

TAGS: EGEN, KS

SUBJ: KOREA ENDS BOOM YEAR MIDST UNCERTAINTIES

REF: A) SEOUL 8451; B) CERP

SUMMARY: KOREA HAS EXPERIENCED RECORD GROWTH OF 16-17 PER CENT IN 1973, MARKED BY LARGE INCREASES IN EXPORTS AND NEW INVESTMENT. FOREIGN EXCHANGE RESERVES HAVE INCREASED TO NEARLY \$1.0 BILLION DESPITE SMALL INCREASE IN GOODS AND SERVICES BOP DEFICIT. THESE FAVORABLE DEVELOPMENTS ARE NOW THREATENED BY IMPORT SHORTAGES AND UNCERTAIN FOREIGN DEMAND, CAUSING GOVERNMENT TO REASSESS POLICIES WHICH HAVE FACILITATED HIGH GROWTH TO DATE.

END SUMMARY.

1. ALTHOUGH ENDING THE YEAR WITH NUMEROUS UNCERTAINTIES RE FUTURE SUPPLIES AND FOREIGN DEMAND FOR ITS EXPORTS,  
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THE KOREAN ECONOMY SEEMS CERTAIN TO ACHIEVE RECORD GROWTH IN GNP AND RAPID EXPANSION IN MANY OTHER MAGNITUDES IN 1973. THE ECONOMIC UPSWING, WHICH BEGAN AFTER AUGUST 1972 STABILIZATION AND GROWTH MEASURES, ACCELERATED RAPIDLY IN 1973,

CAUSING ALL MAJOR INDICATORS TO EXCEED THEIR ORIGINAL FORECASTS, E.G. OF 9.5 PER CENT INCREASE IN GNP. EXPORTS AGAIN LED EXPANSION, INCREASING OVER 50 PER CENT IN REAL TERMS, AFTER A 50 PER CENT RISE IN 1972. BUT GROWTH WAS MORE GENERALIZED IN 1973, LEADING TO AN INVESTMENT BOOM, RISING IMPORTS AND VARIOUS SCARCITIES. THE CURRENT OIL SHORTAGE CAME TOO LATE TO AFFECT 1973 PRODUCTION SIGNIFICANTLY BUT HAS GREATLY DIMMED 1974 PROSPECTS. (ROK ECONOMISTS ARE REPORTEDLY TRYING OUT 16 DIFFERENT ASSUMPTIONS FOR THEIR 1974 FORECASTS.) THE FOLLOWING PREVIEW OF 1973 RESULTS INDICATES THE EX ANTE SITUATION TO BE AFFECTED BY THE UNCERTAINTIES OF 1974.

2. OUTPUT: GNP IN 1973 WILL PROBABLY INCREASE 16-17 PER CENT IN REAL TERMS, COMPARED TO AN AVERAGE GROWTH RATE OF ONLY 8 PER CENT DURING 1970-72 AND A PREVIOUS HIGH OF 15 PER CENT SET IN 1969. DATA FOR FIRST THREE QUARTERS SHOW 20 PER CENT INCREASE OVER LIKE 1972 PERIOD, BUT RATE OF INCREASE LIKELY SLOW TO ABOUT 10 PER CENT IN FOURTH QUARTER DUE TO SHORTAGES AND TO STRONG UPSURGE IN 1972 LAST QUARTER. MANUFACTURING AND INVESTMENT ACTIVITY WERE BOTH UP ABOUT 35 PER CENT IN FIRST TEN MONTHS, CREATING SHORTAGES IN SOME INDUSTRIAL AND CONSTRUCTION MATERIALS. CONSTRUCTION PERMITS WERE UP RECORD 93 PER CENT FROM DEPRESSED 1972 LEVEL, BUT INDUSTRIAL EXPANSION PLANS ARE NOW BEING REVIEWED AND DELAYS OR CANCELLATIONS LIKELY. ABOVE-AVERAGE GROWTH OF 5 - 6 PER CENT LIKELY FOR AGRICULTURE, DUE TO BUMPER RICE CROP. EXPORTS AGAIN LED GROWTH WITH ESTIMATED 1973 INCREASE OF 58 PER CENT IN REAL TERMS, IMPORTS ARE UP AN ESTIMATED 42 PER CENT IN REAL TERMS.

3. BALANCE OF PAYMENTS: 1973 GOODS AND SERVICES DEFICIT LIKELY BE ABOUT \$625 MILLION, ONLY SLIGHTLY LARGER THAN 1972 DEFICIT OF \$541 MILLION. PROBABLE INCREASE OF \$150 MILLION IN TRADE DEFICIT (BOP BASIS) WILL BE PARTLY OFFSET BY HIGHER SERVICES SURPLUS DUE JAPANESE TOURIS. IN CURRENT VALUES COMMODITY EXPORTS AND IMPORTS WILL SHOW RECORD INCREASES OF ABOUT 85 AND 70 PER CENT RESPECTIVELY. DUE TO INCREASED CAPITAL INFLOWS FOREIGN EXCHANGE RESERVES WILL UNCLASSIFIED

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INCREASE ABOUT \$300 MILLION TO NEARLY \$1.0 BILLION, EQUAL TO ABOUT THREE MONTHS IMPORTS FOB. DUE TO PREPAYMENT OF SOME FOREIGN BANK LOANS NET FOREIGN ASSETS WILL INCREASE BY ABOUT \$400 MILLION TO OVER \$850 MILLION.) DEBT SERVICE RATIO WILL FALL FROM 18 PER CENT TO 14 PER CENT IN 1973 AS RESULT SHARP INCREASE IN FOREIGN EXCHANGE EARNINGS. FOREIGN LOAN APPROVALS ARE UP IN 1973 AND APPROVALS OF PRIVATE INVESTMENT (MAINLY JAPANESE) AT END NOVEMBER TOTALLED \$290 MILLION, COMPARED \$114 MILLION FOR ALL 1972. FINANCE MINISTER HAS ANNOUNCED EXCHANGE RATE WILL REMAIN UNCHANGED SINCE EXTERNAL AND INTERNAL INFLATION RATES ABOUT SAME.

4. DOMESTIC FINANCES: DOMESTIC CREDIT WILL INCREASE ABOUT 28

PER CENT THIS YEAR, LOWER THAN LAST YEAR'S 30.5 PER CENT BUT HIGHER THAN TARGETS OF 23.9 AND 26.2 PER CENT SUBMITTED TO IMF IN JANUARY AND JULY. MONEY SUPPLY EXPECTED INCREASE 45 PER CENT, COMPARED 41.2 PER CENT IN 1972, WITH 5 PER CENT RISE IN DECEMBER DUE HEAVY GOVERNMENT RICE PURCHASES. BUDGET CONTINUES TO RUN REVENUE SURPLUS WHICH WILL NEARLY EQUAL GRAIN MANAGEMENT FUND DEFICIT LIMIT OF 67 BILLION WON BEFORE VARIOUS END-OF-FISCAL-YEAR ADJUSTMENTS IN JANUARY. AFTER FIRST-HALF BOOM STOCK MARKET PRICES HAVE DECLINED, FALLING IN PAST MONTH DESPITE SOME GOVERNMENT-INSPIRED SUPPORT PURCHASES BY FINANCIAL INSTITUTIONS. DECLINE HAS PUT DAMPER ON GOVERNMENT PLANS FOR NEW FLOTATIONS. AFTER THREE YEARS OF STAGNATION, NATIONAL (DOMESTIC) SAVING WILL BE UP SHARPLY IN 1973, FROM 15.6 PER CENT TO ABOUT 20 PER CENT OF GNP, SINCE CONSUMPTION HAS BEEN INCREASING ONLY HALF AS RAPIDLY AS GNP, THOUGH AT AN ACCELERATING RATE. SEE REFTEL RE RECENT PRICE INCREASES AND FINANCIAL POLICY MEASURES.

5. COMMENT: WHILE KOREA'S RAPID EXPANSION IN ALMOST ALL ECONOMIC MAGNITUDES IN 1973 HAS NOT (SO FAR) LED TO DETERIORATION IN BALANCE OF PAYMENTS OR ABOVE-AVERAGE INFLATION, IT HAS LEFT THE ECONOMY VULNERABLE DUE TO (1) ITS PRIMARY RELIANCE ON EXPORT EXPANSION, (2) ITS INCREASED DEPENDENCE ON IMPORTED MATERIALS AND OIL, AND (3) THE LARGE VOLUME OF INVESTMENT (E.G. IN TEXTILES) UNDERTAKEN AS A RESULT OF THE BOOM. THE ECONOMY IS ALREADY FEELING THE EFFECT OF IMPORT SHORTAGES. A LEVELING OFF OR DECLINE IN FOREIGN DEMAND IN 1974 COULD CREATE NOT ONLY FOREIGN EXCHANGE PROBLEMS BUT A SERIOUS UNCLASSIFIED

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BUSINESS LIQUIDITY SITUATION, SINCE CAPACITY EXPANSION HAS BEEN EXPORT-ORIENTED AND BUSINESS DEBT-EQUITY RATIOS REMAIN HIGH. GOVERNMENT REACTION TO THESE DANGERS AND UNCERTAINTIES HAS BEEN TO ANNOUNCE THAT (1) FLEXIBLE ECONOMIC POLICIES WILL BE PURSUED FOR THE TIME BEING, WITH EMPHASIS ON STABILITY; (2) THE PRIME SHORT-TERM OBJECTIVE IS TO ASSURE ADEQUATE SUPPLIES OF IMPORTED MATERIALS, AND (3) LONGER-TERM POLICIES WILL PROBABLY BE ORIENTED MORE TO IMPORT-SUBSTITUTION (E.G. INCREASED COAL AND GRAIN PRODUCTION) AND LESS TO EXPORT PROMOTION. THE MASSIVE HEAVY INDUSTRY PLAN FOR 1973-81, ANNOUNCED LAST SPRING, MAY BE DELAYED IN IMPLEMENTATION DUE TO RECENT DEVELOPMENTS. THERE ALSO HAS BEEN SOME QUESTIONING OF ITS STRATEGY OF RELYING HEAVILY ON FOREIGN SUPPLIES, MARKETS AND CAPITAL FOR ITS IMPLEMENTATION. UNDERHILL

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## Message Attributes

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